

COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF PUBLIC UTILITIES

Petition of Massachusetts Electric Company

D.P.U. No. 96-25

REPLY BRIEF OF  
WHEELABRATOR ENVIRONMENTAL SYSTEMS, INC.  
ON  
RESTRUCTURING SETTLEMENT AGREEMENT

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**REPLY BRIEF OF WHEELABRATOR  
ENVIRONMENTAL SYSTEMS, INC.**

Wheelabrator Environmental Systems, Inc. (“Wheelabrator”) submits this Reply Brief in response to the position taken by New England Power Company (“NEP”) and the Division of Energy Resources (“DER”) in their initial briefs in opposition to Wheelabrator’s request for a trust arrangement (“V/C Trust”) to assure payment of its power supply contracts as well as to assure payment to the other NEP creditors (“V/C Claims”) intended to be paid through the Variable Component of the Access Charge. The arguments of DER and NEP rely substantially on the characterization of the trust as an “additional” right. This narrow view, however, ignores that NEP is in liquidation and selling almost 80% of its assets, that through the Fixed Component of the Access Charge, NEP’s shareholders are receiving a guaranteed return and payments ahead of NEP creditors, and that the V/C Trust protects all creditors affected by the Settlement Agreement. Wheelabrator’s position is also supported by Massachusetts law and PURPA, clear policy statements of the Department of Public Utilities (“Department”) and compelling equity interests.

Each of the arguments advanced by DER and NEP is addressed below.

The main arguments set forth by NEP and DER ignore NEP’s obligations and Wheelabrator’s rights under state and federal law. Both NEP and DER argue that Wheelabrator is not entitled to assurances of performance under its contracts with NEP because such assurances are additional rights not provided under any contract. NEP relies on the assertion that “NEP can issue new financing, retire equity, pay a dividend, or sell its assets without Wheelabrator’s prior consent under the contract today,” and should, therefore, not be obligated to obtain such consent at this time. NEP Brief, at 32.

As Wheelabrator noted in its Initial Brief, because NEP is intending to shed 78% of, and its most marketable, assets, getting out of the power purchase business, and changing the very essence of its business, Wheelabrator is entitled to “assurances” of future performance as a matter of state law, even if the contract is silent on this point. Restatement (Second) of Contracts, §251. Wheelabrator is entitled to assurance that NEP will still be able to pay its bills notwithstanding the sea of change undertaken by NEP voluntarily. Wheelabrator proposes that the “assurance” take the form of the V/C Trust. The trust arrangement proposed by Wheelabrator is merely a way to counterbalance additional risk brought about by the Settlement Agreement. This proceeding may be the best opportunity for the concerns of Wheelabrator to be addressed prior to these issues being raised as part of an NEP bankruptcy proceeding.

Moreover, as a matter of state law, a corporation in liquidation must take measures to protect creditors ahead of shareholders. If all goes according to NEP’s plan, NEP will divest itself of 78% of its assets (and may even spin off its transmission assets) and receive an income stream from the Fixed Component designed to effectuate a guaranteed return to shareholders. Yet, NEP complains about the creation of the V/C Trust which does nothing more than take an income stream that is earmarked to pay holders of V/C Claims and makes sure that the money is available for that purpose. Under applicable fraudulent conveyance and dividend statutes there are limitations on actions a corporation can take. Nonetheless, if all goes as requested in the Settlement Agreement, NEP could divest itself of its most marketable assets, pledge the Contract Termination Charges and make a distribution to its shareholder.

As a matter of federal law, a trust arrangement such as the one proposed by Wheelabrator is also appropriate. The Public Utility Regulatory Policies Act (“PURPA”) is intended to assure certainty of contract in order to encourage development of independent power producers (IPPs) such as Wheelabrator. Freehold Cogeneration Assoc. v. Board of Regulatory Commissioners of the State of New Jersey, 44 F.3d 1178, 1190-91 (3d Cir. 1995),

cert. denied, 116 S.Ct. 68 (1995); Smith Cogeneration Management, Inc. v. Corporation Commission, 863 P.2d 1227, 1241 (Okla. 1993). The Federal Energy Regulatory Commission (“FERC”) has also made clear that the development of Qualifying Facilities depends upon the reliability of contracts. New York State Electric and Gas Corp., 71 F.E.R.C. ¶61027, aff’d, 72 F.E.R.C. ¶61067. As a matter of federal law, PURPA also prohibits a state utility from altering an IPP’s contract with a utility absent the IPP’s consent.

The V/C Trust partially protects against the risk that Department approval of the Settlement Agreement will indirectly accomplish under state law that which is preempted by federal law. Through the Settlement Agreement (and the Department’s approval thereof), NEP is changing the face of its business enterprise and increasing the credit risk borne by the IPP’s. NEP is proposing that the Department approve a metamorphosis that in essence “assigns” the IPP contracts to a diminished company consisting of transmission assets which is only 22% of the value of NEP at present and which may also hold nuclear assets that have a negative value.<sup>1</sup> This assignment violates the contract terms, constitutes a contract alteration preempted by federal law and undermines PURPA’s policy of contract reliability. Surely a scheme whereby the Department approves NEP’s plan to divest itself of all its marketable assets, dividend revenues to shareholders and pledge the access charge against new and unspecified borrowings is neither lawful under federal law, including PURPA, nor good policy. The V/C Trust partially mitigates against these risks and further protects the existing (not additional) rights enjoyed by IPP’s under PURPA. Protection of these rights is also consistent with the position taken by the Department in DPU 95-30, in which the Department stated that existing commitments should be honored “because the reliability of commitments in general is an

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<sup>1</sup> NEP’s nuclear assets may be more of a liability than an asset. Testimony of Jesanis, November 22, 1996 Transcript at 12-13. If the nuclear assets have value, they will be sold as part of the divestiture and the Fixed Component relating to the sale will be pledged to lenders.

essential element of any future industry structure.” DPU 95-30, August 15, 1996, at 35.<sup>2</sup>

Regardless of whether one believes that the V/C Trust provides additional rights to IPPs or merely preserves their place in line ahead of NEP’s shareholder, it is appropriate for several policy reasons. NEP is seeking unprecedented borrowing authority that could total billions of dollars for purposes that have not been disclosed on the record. In addition, the V/C Trust proposal is consistent with the Department’s policy to foster reliability of contracts. Moreover, the Settlement Agreement must be in the “public interest.” That interest is better served by the establishment of the V/C Trust that provides assurances that creditors will be paid, especially when shareholders of NEP -- who control NEP’s destiny -- are receiving a guaranteed return through the Fixed Component as well as the potential for additional profits through mitigation bonuses.

DER also makes the argument that Wheelabrator’s trust proposal is not necessary because it is not “economically realistic” that a lender would extend financing under all scenarios contemplated under Attachment 13. DER Brief, at 12. Similarly, NEP asserts that it should be allowed to pledge the V/C because NEP does not intend to allow unlimited borrowing against the V/C. These arguments have little weight because Attachment 13 gives NEP unprecedented borrowing authority. No one can predict the future of economic reality and intentions are not legally binding. Moreover, the fact remains that NEP does intend to pledge the Variable Component and, as a result, a lender would have first priority on this asset on foreclosure or in bankruptcy ahead of the claims of IPP’s and other holders of V/C Claims. If the Variable Component has little economic value to a lender as DER and NEP suggest, then NEP will not be materially harmed if it is barred from pledging this asset. A cautious lender would accept all security available to be pledged regardless of whether it was needed. How

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<sup>2</sup>It is not necessary that the V/C Trust be approved in its entirety at this stage in the proceeding. Approval of the Settlement Agreement could be conditioned on adoption of the V/C Trust with the details of the V/C Trust to be ultimately approved in connection with Department approval of the divestiture plan, which is expected to occur in July of 1997.

could (or why would) NEP say no. But, as the testimony of Mr. Sheehan overwhelmingly demonstrated, NEP does not need to pledge the Variable Component in order to meet its articulated financing needs. Since NEP can obtain financing without the V/C as collateral, but is likely to succumb to a lenders unreasonable demand for supplemental collateral, the solution is clear. If the DPU takes the V/C out of the collateral mix, the lender cannot obtain a lien and as Sheehan's testimony shows, financing can still be obtained. There is no evidence in the record to the contrary.

DER also contends that "[i]n the event that a lender foreclosed on the variable component and tried to take that stream of income, power producers would not be paid and so the variable component would not have to be paid [by ratepayers] in the first place." DER Brief, at 12 -13. This argument proves the point the Wheelabrator wants to make; namely, there is a definite risk to Wheelabrator of nonpayment in the event of foreclosure or bankruptcy. The DER argument also appears to suggest that ratepayers should receive some windfall at the expense of NEP creditors in the event NEP fails as a business enterprise. Such a view is entirely inconsistent with PURPA, and the goals of the Department and PURPA to foster reliability of contracts. It ignores that the 67 Massachusetts cities and towns that contract with Wheelabrator for disposal services would be subject to economic hardship if NEP defaults in paying on the power contract. It also ignores that in a bankruptcy, ratepayers will continue to pay on the Fixed Component even though such funds were used to finance a dividend to NEES as a shareholder of NEP, notwithstanding that creditors did not get paid. The V/C Trust is a major step toward protecting creditors against such risks.

NEP takes the position that it must have the right to pledge the V/C in order to obtain financing. But as noted in Wheelabrator's Initial Brief, M.G.L. c. 164, §14, clearly sets forth the authority given to the Department in approving financing requests.<sup>3</sup> Under this statute the

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<sup>3</sup>Section 14 states that:

Gas and electric companies shall issue *only* such amount of stock and bonds, and of coupon notes and  
(continued...)

Department may only authorize financing that is “reasonably necessary to the accomplishment of some purpose having to do with the obligations of the company to the public and its ability to carry out those obligations with the greatest possible efficiency.” Fitchburg Gas and Electric Light co. v. Department of Public Utilities, 394 Mass. 671, 678 (1985). MECO and NEP do not and the record does not indicate how the broad authority sought under Attachment 13 or the request to pledge the V/C meets these standards.

NEP also takes the position that its ability to pledge the V/C is consistent with the Department’s observation in DPU 95-30 that there may be some “advantage to establishing a stranded cost recovery mechanism with many of the same characteristics as a financial security” so as to promote industry restructuring. NEP does not explain why this is so or how it intends to use this structure to meet the stated goal. Nor does NEP attempt to weigh this benefit with the risks restructuring could face if contract reliability was questioned or if the restructuring process became disorderly because various creditor groups took legal action to protect their interests. Moreover, the V/C Trust could provide a similar advantage since beneficiaries of the Trust could pledge the cash stream and thereby reduce financing costs or raise capital to participate in the restructuring process.

Finally, NEP argues that the V/C Trust somehow interferes with its rights to renegotiate Wheelabrator’s power contracts or implement efficient restructuring efforts under the Settlement Agreement. NEP Brief, at 32. However, it fails to explain this assertion in any way. NEP’s citation to the transcript suggests that it wants the right to pledge the V/C to lenders in order to gain leverage for a buyout of the contracts. Testimony of Jesanis, November 22, 1996 Transcript, at 57-58. If NEP does indeed require the ability to pledge the V/C for this reason, this further justifies Wheelabrator’s concerns. This would mean that NEP

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(...continued)

other evidences of indebtedness payable at periods of more than one year after the date thereof, as the department may from time to time vote is *reasonably necessary* for the purpose for which such issue of stock, bonds, coupon notes or other evidences of indebtedness has been authorized...(Emphasis added).

is seeking approval of a settlement agreement that will provide it with additional bargaining leverage (hence additional rights), rather than one which will deal with all parties on an equitable, status quo ante, basis. Furthermore, if the V/C is ultimately pledged to a lender in a buyout situation, the lender would be more likely to finance the transaction if the owner of the income stream - and the security interest in the V/C - is an IPP, rather than NEP, since there is less regulatory risk in light of the preemptive effect of PURPA. If the Settlement Agreement is approved with the V/C Trust, there will still be sufficient economic and regulatory uncertainty to provide incentives to both parties to engage in good faith negotiations with one another as well as with third party lenders to effectuate "value for value" renegotiation of the power agreements. The Settlement Agreement is not the place for NEP to be seeking additional leverage, especially in the face of the policies enunciated by the Department and in PURPA.

### **CONCLUSION**

The V/C constitutes an income stream designed to pay certain creditors of NEP as a consequence of the sizeable reduction of its business assets. That the V/C even exists demonstrates that these creditor interests are at risk. NEP does not have any superior entitlement to these funds. It is a conduit for funds earmarked for a particular purpose. NEP should not be able to pledge or otherwise use these funds for some other purpose. It has put forth no compelling reason to justify such right. In contrast, creditors have justified concerns. Under contract, corporate and fraudulent conveyance law as well as PURPA, IPP's have justifiable expectations and rights. The V/C Trust does nothing more than make sure that dedicated funds are used for their intended purpose. Adoption of the trust is in the public interest.

**WHEELABRATOR ENVIRONMENTAL  
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By its attorneys,

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